1. EXECUTIVE SUMMARY

Prospects for the global economy have improved slightly since the April 2013 Inflation Report, as a result of improved performance in advanced economies. Global growth is, however, expected to remain uneven. Reflecting the slowdown in emerging economies, the International Monetary Fund (IMF) has, in its October 2013 World Economic Outlook (WEO), downgraded its initial global growth forecast by 0.3 per cent to 2.9 per cent for 2013. Growth should improve somewhat in 2014 rising by 3.6 per cent. Downside risks emanating from still fragile financial market conditions in the Eurozone when coupled with the chance of a reduction in monetary stimulus by the Federal Reserve in the latter half of 2014 remain important and could negatively impact the already moderate global growth outlook. Against this backdrop of vulnerable and uneven global economic recovery, global inflation has remained subdued, though faced with capital outflows and depreciating currencies, some emerging economies have seen an increase in inflation. Global inflationary pressures are expected to remain contained in the medium term as commodity prices continue to ease and demand factors remain weak[1].

The domestic economy continued to hold up relatively well to the soft external economic conditions in our main trading-partner countries. However, conditions remained sub-par, with economic performance below trend. Excluding the negative performance recorded in the construction sector, major sectors recorded positive growth rates. For 2013, sectoral prospects remain mixed. While manufacturing may record higher growth, real activity in 'accommodation and food service activities' is expected to grow only slightly and the construction sector may face a deeper contraction as a result of delays in major public and completion of private projects. The outlook for the emerging 'seafood' and 'ICT' sectors appear relatively better.

The growth outlook for the remainder of 2013 is broadly positive albeit it remains uncertain, with exports weighed down by poor external demand, negative growth in public and private investment and consumer spending relatively weak. While downside risks still exist, some upside potential has recently emerged as the worst of the Eurozone recession appeared to be behind us. Barring negative developments, the expected recovery in the Eurozone, while modest, is forecast to have a positive impact on domestic exports and business as well as on consumer confidence. In September 2013, Statistics Mauritius revised its growth forecast downward for the year from 3.3 per cent to 3.2 per cent. The Bank Staff forecast growth within a range of 3.1-3.5 per cent, down from a previous estimate of 3.2-3.7 per cent made in June 2013.

The domestic economy is still characterised by labour market rigidities, with a mismatch between available jobs and skills within the labour force. Additionally, gender imbalances and youth unemployment continue to prevail, with the female unemployment rate surpassing the male unemployment rate. In the short to medium term, the unemployment rate is likely to remain at around current levels as firms continue to remain cautious when it comes to capacity expansion and hiring, taking into account the weak corporate balance sheets and the uncertain economic climate.

While headline inflation remained steady, y-o-y inflation has experienced a sharp decline in August 2013, mainly as a result of a fall in food prices, the first in the last ten years. Core inflation has remained moderate since the last Inflation Report. The Bank's Inflation Expectation Survey, carried out in August 2013, showed that a majority of respondents expected a rise in the mean inflation rate to 4.7 per cent a year ahead.

Since the last Inflation Report, the majority of members of the Monetary Policy Committee (MPC) have continued to be concerned about the risks of reduced growth, which they saw as outweighing the upside risks to the inflation outlook. The MPC in June 2013 voted to cut the Key Repo Rate (KRR) by 25 basis points to 4.65 per cent. It decided to keep the KRR at this level at the September 2013 meeting, though some members

[1] *IMF's October 2013 World Economic Outlook.*

considered it important to rapidly normalise the KRR to address the vulnerabilities facing the Mauritian economy and offer attractive rates of interest to increase savings and reduce spending.

Assuming no change in the monetary policy stance and a similar impact of the Budget 2014 on prices, as in the previous two years, the Bank's staff forecast of y-o-y inflation is in the range of 4.5-4.9 per cent for December 2013, equivalent to a headline inflation forecast of 3.7-3.8 per cent. By June 2014, y-o-y inflation could reach a range of 4.9-5.5 per cent, equivalent to a headline annual inflation forecast of 4.2-4.5 per cent. Assuming that the budget 2014 has no impact on prices, the staff y-o-y inflation forecast is reduced to a range of 3.7-4.0 per cent for December 2013 and to 4.1-4.6 per cent by June 2014. In the medium term, wage developments in excess of both inflation and productivity growth, continue to pose the greatest risk to price stability.